THE COMPANY LAW AND FOREIGN INVESTMENT ENTERPRISES IN THE PRC – PARALLEL SYSTEMS OF CHINESE-FOREIGN REGULATION

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I INTRODUCTION

When the Chinese-foreign Equity Joint Venture Law[1] ('EJV Law') was first passed in 1979, it was one of a select group of laws which constituted the first step in the re-creation of a Chinese legal system. The EJV Law and the laws relating to foreign investment enterprises which followed it and made possible the establishment of cooperative joint ventures[2] and wholly foreign owned enterprises[3] referred to the concept of limited liability companies. However, until the passage of the General Principles of Civil Law in 1986[4] and the Company Law in 1994,[5] there was no general legal framework in China dealing with corporations. Foreign investors were governed by a separate, relatively well-developed and well-documented legal regime relating specifically to foreign investment entities. They made their own assessment of the risks of investing and operating in China based on this regime and their assessment of the reliability of Chinese regulators and their Chinese partners. The issues with the poorly-developed Chinese court and dispute settlement system meant that the lack of a

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1 Law of the People's Republic of China on Chinese-foreign Equity Joint Ventures, adopted by the Second Session of the Fifth National People's Congress on 1 July 1979; amended at the Third Session of the Seventh National People's Congress on 4 April 1990 and at the Fourth Session of the Ninth National People's Congress on 15 March 2001.

2 Law of the People's Republic of China on Chinese-foreign Contractual Joint Ventures, adopted at the First Session of the Seventh National People's Congress on 13 April 1988; amended at the Eighteenth Meeting of the Standing Committee of the Ninth National People's Congress on 31 October 2000.

3 Law of the People's Republic of China on Foreign-capital Enterprises, adopted at the Fourth Session of the Sixth National People's Congress on 12 April 1986; amended at the Eighteenth Meeting of the Standing Committee of the Ninth National People's Congress on 31 October 2000.

4 General Principles of the Civil Law of the People's Republic of China, adopted at the Fourth Session of the Sixth National People's Congress on 12 April 1986, effective 1 January 1987.

5 Company Law of the People's Republic of China, adopted at the Fifth Session of the Standing Committee of the Eighth National People's Congress on 29 December 1993 ('Company Law'); amended at the Thirteenth Session of the Standing Committee of the Ninth National People's Congress on 25 December 1999, at the Eleventh Session of the Standing Committee of the Tenth National People's Congress on 28 August 2003, and at the Eighteenth Session of the Tenth National People's Congress on 27 October 2005, effective 1 January 2006.

coherent corporate law regime to back up the investment laws was just one of the risk factors which investors and their advisors were obliged to consider.

There has, however, been considerable progress since 1979. The Company Law of 1994 was revised in 2005 in order to deal with the growth of the securities market and the need for better corporate governance of listed companies, and the rapid development of the private sector in China, which has resulted in the expansion of private limited liability companies. The role of the State Administration for Industry and Commerce ('SAIC'), which is responsible for company registration, continues to grow in importance as it expands its regulatory role and the number of private companies in China increases.[6]

Changes and improvements in the Company Law regime have, however, not necessarily improved the position of foreign investors. Despite moves by the State Council in 2004[7] to simplify the approval regime (now a 'verification' regime) for investment, foreign investors are still tied to the traditional forms of foreign investment entity. This position has been confirmed by the provisions of the recently enacted Provisions on Mergers and Acquisitions of Domestic Enterprises by Foreign Investors,[8] which make clear that where a Chinese domestic entity or its assets is acquired by foreign interests, the acquisition must either be done through a foreign investment enterprise or the acquired entity must be converted into a foreign investment enterprise, even if it is already a company established under the Company Law. The intention is clearly to maintain the differentiation between foreign investment enterprises and wholly Chinese-owned companies, which are now generally set up under the Company Law.

There have traditionally been a number of substantial benefits available to foreign investors as a result of this dual system. The privileges associated with foreign investment enterprises have been reduced over time, however, and it can be expected that this differential treatment for foreign investors will in the course of time disappear entirely. Advantages included exemptions from tax and customs duty on imported equipment,[9] the right to engage in export of goods directly without intermediaries,[10] tax holidays, and so on. These concessions have in some cases been reduced or have lost some of their importance. For example, tax holidays and reductions available for 'productive' enterprises, which were designed to encourage the establishment of manufacturing

6 In 2006, there was a 15.8 per cent increase in the number of privately owned enterprises registered in China. See, 'New Corporate Law Drives Growth of China's Private Sector in 2006', *People's Daily Online*, 24 April 2007 <http://english.peopledaily.com.cn/200704/24/print20070424_369117.html> at 11 October 2007.

7 Decision of the State Council concerning Reform of the Investment System, issued by the State Council on 16 July 2004, *Guo fa* [2004] No. 20.

8 Issued by the Ministry of Commerce, the State-owned Assets Supervision and Administration Commission of the State Council, State Administration of Taxation, State Administration for Industry and Commerce, China Securities Regulatory Commission and State Administration of Foreign Exchange, No 10 (2006), on 8 August 2006, effective 8 September 2006, arts 2, 7.

9 Article 71 of the (original) Regulations for the Implementation of the Chinese-foreign Equity Joint Venture Law of the People's Republic of China, issued 20 September 1983 by the State Council ('Original EJV Regulations'); amended 15 January 1986; 21 December 1987 and 22 July 2001 ('EJV Regulations').

10 Original EJV Regulations, art 62.

operations, have become less significant as foreign investors have gradually been permitted to invest in services. The revisions to the Foreign Trade Law in 2004 opened up import and export of goods to any enterprise which registers as a foreign trade operator.[11] The new Enterprise Income Tax Law,[12] which will come into effect on 1 January 2008, will abolish the tax preferences granted specifically to almost all foreign investments in favour of preferences awarded on the basis of technological level, environmental and other considerations.

There continue to be benefits which are available as a result of utilising the foreign investment form. These include a greater ability to access foreign funds for debt purposes, and readier access to foreign exchange, although traditional restrictions and limitations on Chinese entities remitting currency and investing overseas have been relaxed considerably over the last few years.

In summary, although the regulatory regime requiring the separation of Chinese and foreign investment enterprises remains intact, it is questionable whether the strict differentiation between Chinese companies and foreign investment enterprises is now justified by the different treatment accorded to Chinese and foreign investors or offers benefits to foreign investors which outweigh the inconveniences of utilising the existing foreign investment enterprise structures, particularly in the case of Chinese-foreign joint ventures. In particular, the recent revisions to the Company Law, with their emphasis on corporate governance and improved rights for shareholders, raise issues about the extent to which they should also be applied to the governance and structure of foreign investment enterprises. A number of important documents issued in 2006 by SAIC and other ministries shed some light on this issue and suggest a move towards convergence of the foreign investment and company law regimes.[13] The purpose of this article is to examine the extent to which convergence has occurred or is likely to occur as a result of these changes.

II JOINT VENTURES – STRUCTURES AND ISSUES

As an initial point, it has been clear for some time that foreign investors have formed their own unfavourable view on the joint venture structure. In 2006, almost three-quarters of new investment projects took the form of wholly foreign owned enterprises, with joint ventures constituting approximately 27 per cent of

11 Foreign Trade Law of the People's Republic of China, as revised and adopted by the Eighth session of the Standing Committee of the Tenth National People's Congress on 6 April 2004, effective 1 July 2004, art 9.

12 Enterprise Income Tax Law of the People's Republic of China, adopted at the Fifth Session of the Tenth National People's Congress on March 16, 2007, effective 1 January 2008.

13 See Peter A Neumann, 'China's Foreign-invested Companies: A Standardization of Practices' (July 2006) *China Law & Practice* 1; Neal A Stender and Yan Zeng, 'China's Foreign Invested Companies Changing & Converging with Domestically Owned Companies' (September 2006) *Hong Kong Lawyer*, 45-49; *Freshfields: China notes – June 2007:* Company Law Provisions for the Appointment of Supervisors (2007) Freshfields Bruckhaus Deringer <http://www.freshfields.com/places/china/publications/chinanotes/200706/en.asp> at 11 October 2007.

the total number.[14] Part of this shift away from joint ventures can be attributed to the fact that foreign companies feel more confident that they can manage in China without the assistance of a Chinese partner. In addition, as the Chinese economy has opened up, it is no longer generally necessary, or indeed desirable, to acquire State-owned Enterprises ('SOEs') in order to obtain their facilities or access to their markets, or as a means of obtaining approval for a particular project. However, the difficulties that foreign companies have experienced in working with Chinese partners are also relevant to this decision.

A significant contributor to these difficulties is the legally required structure of a joint venture in China. A Chinese-foreign joint venture, with the exception of the new requirement to appoint supervisors, is still, in terms of structure and management, regulated by the laws and regulations relating to equity joint ventures and contractual joint ventures, which significantly limit the ability of the partners to set up a corporate structure which resembles either a limited liability company or a western proprietary company. In a joint venture, even where the foreign investor holds a majority interest, its ability to actually control the entity is limited. This is due both to the legal restraints on the freedom of the parties to agree to their own structural arrangements in the contract and, of course, to practical issues of control. Problems include a regulatory regime which requires that certain decisions be taken by a unanimous decision of the board of directors, effectively giving the minority partner or partners a veto;[15] the illiquidity of the equity interests, due to the statutory requirement that the consent of the other parties and the approval authorities be obtained for a transfer of an equity interest,[16] and the difficulty of winding up or terminating the company. This is significant because there are still advantages in engaging in joint projects with Chinese partners. In addition, there are still certain areas in which a joint venture is effectively the only permitted structure. These include certain industry areas where foreigners can only invest in conjunction with Chinese companies, such as steel,[17] production of high quality paper and cardboard, and prospecting and mining of aluminium ore.[18] For foreign and Chinese investors, therefore, a more flexible and workable joint venture structure would be highly desirable.

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14 See US-China Business Council, 'FDI in China', based on statistics for 2005 and 2006 issued by the Ministry of Commerce, <http://www.uschina.org/statistics/fdi_cumulative.html> at 25 September 2007.

15 EJV Regulations, art 33; Regulations for the Implementation of the Law of the People's Republic of China on Chinese-foreign Contractual Joint Ventures, approved by the State Council on 7 August 1995, issued on 4 September 1995 (the 'CJV Regulations') art 29.

16 EJV Regulations, art 20; CJV Regulations, art 23. Article 20 of the EJV Regulations also grants the other party a pre-emptive right to acquire the interest to be sold.

17 See, Policies on the Development of the Steel Industry, issued by the National Development and Reform Commission on 20 July 2005, art 23.

18 Catalogue for the Guidance of Foreign Investment Industries (amended 30 November 2004 and effective 1 January 2005), promulgated by the State Development Planning Commission, the State Economy and Trade Commission and the Ministry of Foreign Trade and Economic Cooperation on 11 March 2002; amended by the State Development and Reform Commission and the Ministry of Commerce on 30 November 2004. Catalogue of Encouraged Foreign Investment Industries, III(6)(2), II(10).

III RECENT DEVELOPMENTS

In 2006, a number of steps have been taken, largely by the SAIC, to bring the structure and management of foreign investment entities into line with other Chinese companies. These steps require new entities (as well as already established entities making major changes to their Articles of Association) to modify their structure in order to comply in certain ways with the Company Law. Indeed, under its latest Interpretation, the SAIC appears to be claiming a review and approval power in relation to the constituent documents of foreign investment companies which is in addition to (and possibility in conflict with) the approval/verification process with the Ministry of Commerce ('MOFCOM') and its designees required prior to the establishment of a foreign investment enterprise. This is, of course, a process which Chinese companies are not obliged to undergo.

In April 2006, an Opinion was jointly issued by the SAIC, MOFCOM, the General Administration of Customs and the State Administration of Foreign Exchange relating to the approval and registration of foreign investment enterprises.[19] This was followed in May[20] by a Circular issued by SAIC and in September by a further Interpretation issued by the SAIC.[21]

Article 1 of the Opinion attempts to clarify the provisions of article 218 of the revised Company Law, which states that '[f]oreign investment limited liability companies and joint stock companies shall apply this law; if relevant foreign investment laws otherwise provide, they shall apply those provisions.' Article 1 of the Opinion sets out an order of priority in relation to the application of laws and regulations relating to the registration of foreign-invested companies as follows: first, the Company Law and the Rules on the Administration of Company Registration,[22] unless laws regarding foreign investment enterprises otherwise stipulate, in which case those stipulations should be followed; secondly, administrative regulations and State Council Decisions on foreign investment enterprises, and other national regulations relating to foreign investment. This provision emphasises that only foreign investment *laws*[23] will

19 Implementing Opinion on Several Issues Concerning the Application of the Law in the Administration of the Examination, Approval and Registration of Foreign Investment Enterprises, issued by the State Administration for Industry and Commerce, the Ministry of Commerce, the General Administration of Customs and the State Administration of Foreign Exchange on 24 April 2006.

20 Circular on Implementation of the 'Implementing Opinion on Several Issues Concerning the Application of the Law in the Administration of the Examination, Approval and Registration of Foreign Investment Enterprises,' issued by the State Administration for Industry and Commerce on 26 May 2006.

21 Interpretation of Key Provisions of the 'Opinion on the Implementation of Several issues on Laws Applicable to the Administration of the Approval and Registration of Foreign Investment Enterprises', issued by the Foreign Investment Enterprises Registration Bureau of the State Administration for Industry and Commerce on 22 September 2006.

22 Rules on the Administration of Company Registration of the People's Republic of China, issued by the State Council on 18 December 2005, effective 1 January 2006.

23 Pursuant to the Law on Legislation of the People's Republic of China, adopted at the Third Session of the Ninth National People's Congress on 15 March 2000, and effective on 1 July 2000, art 7, laws can be passed only by the National People's Congress or the Standing Committee of the National People's Congress.

override the Company Law; it also gives the Rules on the Administration of Company Registration (issued by the State Council in relation to all companies) higher status than rules and provisions relating to foreign investment (even if issued at the same level and relating specifically to foreign investment).[24] The applicability of the Opinion, the Circular and the Interpretation raises a number of questions, as they are themselves issued at a level lower than the State Council, although the Opinion was also approved by the relevant agencies dealing with foreign investment enterprises. These documents have practical effect due to the ability of the SAIC to refuse to register enterprises unless the requirements are satisfied. They have legal value presumably as implementing legislation for the Company Law and the Rules on the Administration of Company Registration, although like much Chinese implementing legislation they seem in some respects to go beyond the specific scope of the legislation which they purportedly implement.

Article 218 of the Company Law is in essentially the same terms as article 18 of the 1994 Company Law, although it adds a reference to joint stock companies. The exact meaning of this provision was always unclear, but in the past foreign investors have assumed – an assumption that was borne out by practice – that after complying with laws and regulations relating to foreign investment enterprises, and obtaining an approval from the Ministry of Commerce or relevant government approving body, it was not necessary to take further steps other than filing for registration. It is no longer possible to rely on this assumption. The effect of the Opinion, as further expanded by the Circular and the Interpretation, appears to be that only if the laws relating to foreign investment enterprises have a positive requirement which contradicts the Company Law will the operation of the Company Law be excluded. There does not appear to be anything to prevent the imposition of further requirements in the course of the registration process as long as they are included in the Company Law and do not purport to override specific provisions of the foreign investment laws. The SAIC now takes the view that it is open to the SAIC to impose requirements on foreign investment enterprises such as the appointment of supervisors as long as the EJV Law does not specifically provide that an EJV is not required to have supervisors. This is despite the fact that the laws and regulations relating to equity joint ventures can be read as creating a complete regulatory regime in relation to management. Indeed, as discussed below, it is not clear exactly how the supervisory board will operate in an equity joint venture, given that there is no strict structural distinction made in a joint venture between shareholders and directors.

24 Article 85 of the Law on Legislation provides that where there is a difference between a new general administrative rule and an old special administrative rule on the same matter, a ruling shall be made by the State Council. The EJV Regulations and the CJV Regulations, for example, were both issued or approved by the State Council.

A Impact on Wholly Foreign Owned Enterprises

The major changes made in the Opinion relate to wholly foreign owned enterprises ('WFOEs' or 'wholly foreign owned companies', as they are referred to in the Opinion). The Interpretation makes clear that some changes will also be required in the corporate structure of joint ventures. In the case of WFOEs, neither the Law of the People's Republic of China on Foreign-Capital Enterprises[25] nor the Rules for the Implementation of the Law of the People's Republic of China on Foreign-Capital Enterprises[26] sets out any specific requirements in relation to structure, other than general requirements that the application to establish the entity should specify the organisational structure. As a result, the traditional WFOE has had a board of directors or committee of management, but no shareholders' meeting or supervisory board. Although on one view (the view which appears to have been adopted from 1994 to 2005), this could be regarded as a permissive requirement which has, since 1986, given foreign investors the discretion to choose their own management structure (with some input from the approval authorities), the view now being taken by the SAIC is that article 218 of the Company Law, and its own power over registration of companies, allows the SAIC to require that the structure adopted by a WFOE complies with the Company Law. Where a Chinese company, however, need only submit its Articles of Association to the SAIC for registration, a foreign investor must still go through the approval process for a foreign investment enterprise and then submit the approved Articles of Association to the SAIC, which will check for compliance with the Company Law.

What this means is that, with the exception of a WFOE with only one shareholder, a wholly foreign owned company set up after 1 January 2006 should have the three-tier structure required by the Company Law, with a shareholders' meeting, board of directors and supervisory board or supervisors. A newly-established WFOE with one shareholder is subject to the requirements of articles 58 to 64 of the Company Law, which deal specifically with one-shareholder companies. An advantage which is potentially offered by the requirement to use the Company Law structure is that with a shareholders' meeting it is possible to have numerous shareholders, without necessarily being required to give each shareholder a board seat (a practical necessity when the board is the only management organ). The provisions of the Company Law which require a super-majority vote of two-thirds of the shareholders for certain matters also make it easier to have more shareholders in the company.[27]

In a practical sense, foreign investors in new enterprises may not be much affected by this change. Although joint venture contracts are submitted for

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25 Adopted at the Fourth Session of the Sixth National People's Congress on 12 April 1986; amended by the Eighteenth Meeting of the Standing Committee of the Ninth National People's Congress on 31 October 2000.

26 Issued on 12 December, 1990 by the Ministry of Foreign Relations and Trade, as approved on 28 October 1990 by the State Council, and amended by the State Council on 12 April 2001.

27 Article 44 of the Company Law provides that two-thirds or more of the shareholders by voting rights must agree to an amendment to the Articles of Association, change of the registered capital, merger, division, dissolution or change of company form.

approval by the relevant authorities and have a clearly recognised status under the EJV Law and the CJV Law, agreements between foreign shareholders in relation to WFOEs do not have the same status. Pursuant to article 10 of the Regulations for the Implementation of the Law of the People's Republic of China on Foreign-Capital Enterprises, shareholders' agreements between the foreign investors must be submitted 'for the record' to the approval authorities. Unlike a joint venture contract, which is approved by the authorities, any legal status that they have is purely contractual.

The investors often set up an overseas or Hong Kong holding company which becomes the single investor in the Chinese enterprise, and regulate their relationship through an offshore shareholders' agreement, backed up by provisions in the constituent documents of the offshore entity. This is due both to a reluctance on the part of foreign investors to show the agreement to government authorities, and to a preference for foreign courts and foreign systems of law, where there is more than one investor. The Company Law does not refer to the concept of a shareholders' agreement, although article 28 suggests that the Articles of Association, which are signed and sealed by the shareholders pursuant to article 25, should be regarded as constituting a contract between the shareholders.[28] In a company governed by the Company Law, therefore, the prudent course of action would be to incorporate the agreement between the parties into the Articles of Association to the extent possible and to back it up with a shareholders' agreement. The disadvantage of this course of action, however, is that the agreement would, in the case of a WFOE, still have to be disclosed to the approval authority, and, as an agreement between the shareholders of a Chinese company, might still as a practical matter have to be litigated before Chinese courts if a party seeks a remedy relating to the operation of the Chinese entity. The provisions in the revised Company Law which give remedies to the shareholders as against the directors and other shareholders,[29] as well as the right to require the company to purchase a disgruntled shareholder's shares in certain circumstances[30] or to petition the court for dissolution of the company[31] might be helpful to a minority shareholder. However, these remedies deal mainly with the rights of shareholders against majority shareholders or directors – they do not deal with shareholder disputes. In addition, at this stage it is not clear how robustly these provisions will be applied in the Chinese system. Although the Opinion refers specifically to the category of 'foreign joint venture,'[32] foreign investors may still be best advised to submit their joint venture structure to offshore regulation.

28 Article 28 of the Company Law provides that where a shareholder fails to make the capital contribution to which it has subscribed as set out in the Articles of Association, it shall be liable both to the company for the amount of the contribution and to the shareholders who have made their capital contributions in full 'for breach of the contract.'

29 Set out in Company Law, arts 20-22, 148-153.

30 Company Law, art 75.

31 Company Law, art 183.

32 Opinion, art 6.

If the WFOE is set up as a single shareholder company, it is not required to have a shareholders' meeting, as article 62 allows for all matters that would otherwise be decided by the shareholders' meeting to be approved by a written resolution of the sole shareholder. This section does not, however, eliminate the obligation to have a board of directors or to appoint supervisors.

B Impact on Joint Ventures

Joint ventures are also affected by new requirements to comply with the Company Law, albeit to a limited extent. The Company Law structure contemplates a three-tier structure – shareholders, directors and supervisors. The EJV Law and EJV Regulations provide for one tier – a board of directors to which the directors are directly appointed by the parties to the joint venture. Traditionally, the EJV has operated like an incorporated partnership, with deadlock on the board of directors a constant risk for the investors in the company. There has been no legislatively mandated separation between the investors as shareholders and the directors as independent managers of the company. Provisions to mandate such a separation, as well as to incorporate the concept of a duty to act independently in the best interests of the company, have generally been incorporated by agreement into the Articles of Association or Joint Venture Contract of the company. There have traditionally been no supervisors for an EJV or CJV, as they were not required either by the relevant legislation or by the Ministry of Commerce in the course of approving the establishment of foreign investment enterprises. This position, however, has now changed. The September Interpretation issued by the SAIC makes clear that new joint ventures are now required to appoint supervisors or a supervisory board.

The role of the supervisors is set out in the Company Law. Prior to the recent amendments (and even after), there was substantial criticism of the role played by the supervisors, on the basis that they did not play a useful role in supervising the conduct of the company or protecting the stakeholders in the company.[33] The revisions to the Company Law have the effect of giving the supervisors substantially more ability to take action. A small company, or a company with a limited number of shareholders, must have one or two supervisors, but is not required to appoint a supervisory board.[34] A larger company, however, must have a supervisory board of at least three members, of which at least one third should be supervisors elected by the employees of the company.

Pursuant to article 54, the supervisors have the power to recommend the removal of directors and senior management personnel who have violated laws, administrative regulations, the Articles of Association or shareholder resolutions. The supervisors also have the power to propose and convene extraordinary meetings of the shareholders in certain circumstances,[35] to make proposals

33 See, eg, CFA Institute Centre for Financial Market Integrity, *China Corporate Governance Survey* (2007), 5.1, 5.5 <http://www.cfapubs.org/doi/pdf/10.2469/ccb.v2007.n3.4563> at 25 September 2007.

34 Company Law, art 52.

35 Company Law, art 54(4).

directly to the shareholders' meeting,[36] and to make inquiries or suggestions to the board of directors' meeting.[37] In the case of a company with no shareholders' meeting, some of these powers are clearly not relevant. However, the supervisors may also conduct investigations if they discover irregularities in the operations of the company, and retain accountants at the expense of the company, to assist it to do so.[38] Pursuant to article 57, the costs and expenses of the supervisors will be borne by the company.

These powers raise a number of interesting issues in the case of a joint venture. First, if the supervisors do decide to recommend the removal of a director, to whom should the recommendation be made? In the case of the directors of a limited liability company, the recommendation is presumably made to the shareholders, who have the power to elect and remove directors. In the case of a joint venture, such a recommendation would presumably be made directly to the investors since there is no shareholders' meeting. Generally speaking, however, under the EJV regime, a director is appointed directly by a specified investor and the joint venture documentation often provides that he or she may only be removed by that investor.[39] Similarly, in relation to senior management, the allocation of the right to nominate persons to particular management positions is generally closely negotiated between the joint venture parties.

In both of these cases, a recommendation by the supervisors would be highly sensitive, particularly where management power is delicately balanced between the joint venture parties in the joint venture contract. It seems likely, therefore, that the issue of the number of supervisors, who should appoint them and whether the joint venture is large enough to require a board of supervisors and hence an employee representative will become matters for intense negotiation. In particular, the question whether the supervisors can carry out their functions under the Company Law will depend on who appoints them. One issue from the point of view of the foreign party is whether the employee representative should be considered to be truly independent or effectively another vote for the Chinese party.

Article 152 obliges the supervisors, if requested by a shareholder, to take legal action against a director or representative of senior management who has (or who it is alleged has) violated a law, administrative regulation or a provision of the Articles of Association and thereby caused losses to the company, if so requested by a shareholder. Such an action would be taken where, for example, a director has failed in his duty to the company, as set out in article 148 or 149. This in turn

36 Company Law, art 54(5).

37 Company Law, art 55.

38 Company Law, art 55.

39 An interesting solution to the restrictions on certain persons acting as directors under the Company Law (now found in art 148) can be found in art 7.1.6 of the Equity Joint Venture for the Establishment of BMW Brilliance Automotive Ltd, by and between BMW Holding BV and Shenyang JinBei Automotive Industry Holdings Company Limited (2003) <http://contracts.onecle.com/brilliance/bmw.jv.2003.03.27.shtml> at 25 September 2007, which provides that a party must immediately discharge a director it has appointed to the board on discovering that he/she has violated the equivalent provisions to arts 70 and 148 of the old Company Law.

raises the interesting question of the applicability of the duty of fidelity imposed by article 148 to directors of joint ventures. As noted above, the distribution of directors of an EJV is allocated in proportion to the equity representation of the investors.[40] The matters resolved at board level for which a unanimous vote of the directors is required pursuant to article 33 (amendment of the Articles of Association, termination, merger, division and change of registered capital) are matters which are generally resolved by the shareholders under the Company Law structure. It is clear, from both the legislation and negotiations by the investors, that the directors are expected to represent the investors who appointed them, at least when voting on these and other matters for which a super-majority vote is required by the joint venture contract. While acts of dishonesty, as outlined in article 149, are certainly matters which no director or officer of the company should be permitted to engage in, it is not clear that the duties of the (necessarily) conflicted director of a joint venture company should be exactly the same as those of a director of a limited liability company. For example, is a director in breach of his duty under article 149(7) if he reveals confidential information of the joint venture to officers of the investor which appointed him? Under article 152, a decision to take action can be made by the board of supervisors or the sole supervisor, and if the board or the supervisor fails to take the appropriate action, the aggrieved shareholder can take action themself.

On the one hand, the ability to take action directly against directors appointed by the other party for acts of dishonesty or improper conduct may be appealing to an investor, particularly if the other party has refused to cooperate in removing the director when requested. On the other hand, in a joint venture, disputes over the actions of directors may in reality be disputes between the joint venture parties. Since disputes between the investors in a joint venture should be resolved pursuant to the dispute resolution mechanism set out in the joint venture contract, the avenue offered here may also present an opportunity to a party to initiate what is really a joint venture dispute in a forum to which the parties have not agreed.

IV CONCLUSION

In summary, despite the hopes expressed by various writers,[41] the changes made in 2006 do not represent a major move towards convergence of the dual systems of regulation of Chinese and foreign investment companies. Although they make some primarily cosmetic changes, they have little impact on the structural difficulties presented by the joint venture structure. In fact, the addition of the requirement to appoint supervisors for joint ventures, far from resolving any structural issues, potentially adds to the complexity of negotiating and operating joint ventures and certainly does not resolve the major issues which make joint ventures unattractive to foreign parties.

40 EJV Regulations, art 31.
41 See above n 13.

In view of the growth of the private sector in China, the gradual removal of the traditional incentives offered specifically to foreign investors and the consolidation of the tax system, it is an opportune time for Chinese policy-makers to consider repealing the joint venture laws and encouraging the establishment of incorporated joint ventures in the form of limited liability companies set up under the Company Law.[42] Some of the steps required to achieve this would include the promulgation of legislation to support the validity and binding nature of shareholders' agreements between foreign and Chinese investors to replace joint venture contracts and to deal with the question of approval/verification of the investment project. This would resolve a number of the structural difficulties discussed in this article: a limited liability company can have more than two or three shareholders, since the shareholders are represented in the shareholders' meeting and do not necessarily have to be represented on the board of directors; officers of the company could be appointed pursuant to the shareholders' agreement or by an elected board of directors, and the transferability of shares would be governed by the shareholders' meeting and the provisions of the Articles of Association of the Company.

Although there is much to be said for the convergence of the two systems, it appears that we are still some considerable distance away from such a determination being made by the Chinese Government.

42 The Company Law structure is not completely sympathetic to cooperative or contractual joint ventures. As the US-China Business Council statistics cited (above n 14) indicate, however, cooperative joint ventures constituted less than 3 per cent of all foreign investment entities set up in 2005 and 2006. In addition, the Partnership Law (issued by the 24th Session of the Eighth National People's Congress on 23 February 1997; amended by the 23rd session of the Tenth National People's Congress on 27 August 2006, effective 1 June 2007) potentially offers equally flexible structures for investors.